

# **REPORT OF THE AUDITOR-GENERAL TO THE KWA-ZULU NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF DANNHAUSER MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I was engaged to audit the accompanying financial statements of the Dannhauser Municipality which comprise the balance sheet as at 30 June 2008, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

### **Responsibility of the accounting officer for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007)(DoRA). This responsibility includes:
  - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

### **Responsibility of the Auditor-General**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### **Basis of accounting**

4. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting as set out in accounting policy note 1.

### **Basis for disclaimer of opinion**

### **Corresponding figures**

5. The auditor's report on the prior period, as previously issued, included a disclaimer of opinion and the matter that gave rise to the modification that remained unresolved, and resulted in a modification of the auditor's report regarding the current period figures.

6. There were unexplained differences between the previous year closing balances and the current year opening balances as the accounting system was not closed after each year end resulting in transactions being processed in the incorrect period.
7. Consequently there were no satisfactory audit procedures that could be performed to obtain reasonable assurance for the valuation, existence, completeness and the municipality's rights and obligation of the balances in the current year and prior year financial statements.

### **Commitments**

8. Documentation to support the commitments of R16,77 million (2007: R14,38 million) disclosed in note 23 to the financial statements could not be produced. The entities records did not permit me to perform alternative audit procedures as no commitments register was maintained by the municipality. Therefore, I was not satisfied with the existence and completeness of commitments.

### **Grants and Assistance**

9. Grants received, expensed and unspent as recorded in the grants register do not agree to the general ledger and financial statements. The differences of grants received in the income statement (R5,19 million) and unspent grants in the balance sheet (R2,09 million) could not be explained.
10. Grant income of R500 000 in the trial balance was not reflected in the financial statements.
11. The accounting records did not permit me to perform alternative audit procedures as a result I was unable to obtain sufficient audit evidence to satisfy myself as to the existence, completeness and valuation of grants and assistance.

### **Receivables**

12. An accurate and complete age analysis for consumer debtors of R5,35 million as disclosed in note xx to the financials could not be provided. In addition no supporting documents could be provided to substantiate the amounts of R4,73 million described as opening balance transfer, debtors' balances of R576 000 reflecting movements in the current year, debtor balances of R3,61 million brought forward from the prior, and cash and income suspense accounts to the value of R5,35 million. Moreover a reconciliation prepared by the municipality for refuse debtors did not agree to the amount reflected in the general ledger, resulting in an unexplained difference of R588 000. Staff debtor accounts of R720 000 in the general ledger have not been included in the debtors balance in note 8. The municipality's accounting records did not permit me to perform alternative audit procedures. Consequently, I was unable to satisfy myself as to the existence, completeness, and valuation of the debtors balance.
13. Credit balances of R369 000 (2007: R1,95 million) have been off-set against debtors and not transferred to creditors. As a result debtors and creditors are understated by an amount of R369 000.

### **Revenue**

14. Included in rates and general is rates income to the value of R 4,65 million. A reconciliation between the general ledger and the valuation roll revealed an

unexplained difference of R407 000. As a consequence the occurrence, accuracy and completeness of rates revenue including penalties and interest totalling R4,65 million and refuse revenue of R314 000 could not be confirmed.

15. Penalties and interest amounting to R1,36 million (2006/07: R311 000) have been included in the value of assessment rates disclosed in note 12 to the financial statements resulting in an overstatement of assessment rates by R1.36 million. .
16. The value of rateable land and buildings of R87,48 million disclosed in note 12 to the financial statements:-
  - did not agree to the valuation roll totalling R131,57 million;
  - excluded the value of non-rateable land and buildings of R10,67 million;
  - disclosed the incorrect valuation date; and
  - did not disclose a breakdown of rateable land and buildings.
17. Included in rates and general, in the financial statements is revenue of R169 000 for which no supporting documentation could be provided. The municipality's records did not permit me to perform alternative audit procedures. Consequently I was unable to satisfy myself as to the occurrence, accuracy and completeness, of revenue to the value of R169 000.

### **Creditors**

18. Included in Creditors of R12,82 million as disclosed in note 10 to the financial statements are unsupported suspense account credit balance of R2,91 million , debit balance R2,56 million and prior year balances of R3,93 million. An amount of R538 000 included in creditors was also included in loans redeemed and other capital receipts. The entity's records did not permit me to perform alternative audit procedures regarding payables. Consequently, I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the existence, completeness, obligations and valuation of payables.
19. Unspent grants is overstated and other creditors understated by R152 000 for a retention creditor that was incorrectly classified in the accounting records.

### **Statutory Funds**

20. The following are salient discrepancies highlighted by my audit of statutory funds:
  - No supporting reconciliations could be provided to substantiate the statutory funds of R4,79 million as disclosed in note 1 to the financial statements.
  - No contribution was made to the capital development fund for the current year as required by section 103(9)(b) of the Local Authorities Ordinance, No, 25 of 1974 (Ordinance). I am calculating this amount at R782 000 (2007: R703 000).
  - Fifty percent of total interest earned on investments of R1,46 million, has not been allocated to the statutory funds as required by section 103(9)(b) of the Ordinance.
  - No supporting documents could be provided for the expenditure of R394 000 against the public improvement fund.

21. The municipality's records did not permit me to perform alternative audit procedures. Therefore, I could not obtain sufficient audit evidence to satisfy myself as to the existence, completeness and valuation of statutory funds.

#### **Housing Operating Account**

22. The housing operating account and revenue is understated by R100 000 relating to rental income, not recorded in the general ledger.

#### **Value Added Tax (VAT)**

23. No VAT reconciliations were performed between the VAT returns and the general ledger. VAT was incorrectly processed for the year at two and a half percent. In addition documentation to support the VAT output suspense account balance of R83 000 (2007: R13 000) could not be provided. I was unable to satisfy myself as to the completeness, and valuation of VAT of R 296 000 as disclosed in note 8 to the financial statements.

#### **Fixed Assets**

24. Fixed assets of R2,38 million is disclosed in note 4 to the financial statements. My audit of the fixed asset, revealed that assets are understated by R 1,71 million in respect of additions not recorded in the general ledger. Moreover, I could not confirm existence and valuation of fixed assets due to various limitations placed on the scope of my audit. I was therefore unable to satisfy myself as to the existence, completeness, and valuation of fixed assets.
25. Assets purchases funded by grants is understated and repairs and maintenance expenditure is overstated by R1,86 million because grant expenditure has been incorrectly classified and expensed in the accounting records of the municipality.
26. In the prior year a difference of R366 000 existed between the asset register and the financial statements, this matter remains unresolved.

#### **Investments**

27. I was unable to satisfy myself as to the existence, completeness, rights and valuation of investments to the value of R2,53 million because no supporting documentation or explanations could be provided. In addition the reconciliation between the bank statement and the general ledger revealed an unexplained difference of R1,51 million. In this regard, alternative procedures were not feasible as an investment register was not maintained by the municipality.

#### **Related Parties**

28. No supporting documents could be provided for the debtor of R233 000 and creditor of R1,36 million in the name of the District Municipality. The completeness of the transfer of the water function to the District Municipality could not be confirmed. Therefore, I was unable to satisfy myself as to the completeness and valuation of the amounts owing by/to the District Municipality.

#### **Accumulated Surplus**

29. The amount disclosed in the financial statements does not agree to the trial balance resulting in an understatement in the financial statements of R989 000. In addition no supporting documents could be provided for adjustments of R 324 000 processed during the year under review. The municipality's records did not permit me to perform

alternative audit procedures. As a result, I was unable to satisfy myself as to the occurrence, completeness, and accuracy of the accumulated surplus of R10,45 million as disclosed in the financial statements.

### **Provisions**

30. I was unable to satisfy myself as to the existence, completeness, obligations and valuation of provisions disclosed as R890 000 in note 9 to the financial statements for the following reasons as the municipality's record did not permit me to perform alternative procedures:

- The necessary supporting documents and reconciliations considered necessary for my audit could not be obtained.
- Supporting documents to audit the leave pay provision balance of R655 000 (2007: R 655 000), which also recorded no movement since the prior year, could not be obtained during the audit.
- Leave encashment totalling R361 000 paid out during the year was not recorded against the provision account.
- The leave pay provision of R655 000 has been disclosed twice in the financial statements as a provision and part of the unspent grants creditor.

### **Cash and Cash Equivalents**

31. Note 21 to the financial statements discloses cash to the value of R844 000. My audit of the bank reconciliation revealed a difference of R569 000. No supporting documentation or explanations were provided to satisfy myself of the existence and valuation of the balance. The municipality's records did not permit me to perform alternative procedures.

### **Reserves**

32. Included in reserves of R125 000 disclosed in note 2 to the financial statements were the DM funding reserve of R42 000 and the existing renewals fund rate and general service reserve of R83 000. Supporting documentation, appropriate explanations, and a council approval could not be provided for the creation and contributions to these reserves. Consequently I could not satisfy myself as to the completeness and valuation of reserves.

### **Financial Statements**

33. The following unexplained material misstatements / disclosure discrepancies were identified in the financial statements:

- The auditor's remuneration in note 14 did not agree to the actual expenditure in the income statement. There was a difference of R50 000
- The redemption of external loans in note 15, and the income statement did not agree. There was a difference of R875 000.
- The cash flow statement cannot be verified due to errors noted in auditor's remuneration, redemption of external loans and capital outlay notes in the financial statements.
- The classification of creditors in note 10 between trade and other creditors is misstated by R372 000.

## Disclaimer of opinion

34. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of Dannhauser Municipality. Accordingly, I do not express an opinion on the financial statements.

## OTHER MATTERS

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

### Internal controls

35. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Commitments	✓				
Grants and assistance	✓		✓		
Receivables	✓		✓		
Revenue			✓		
Payables	✓		✓		
Statutory Funds			✓		
Housing Operating Account					
Value Added Tax	✓		✓		
Fixed assets	✓	✓	✓		
Investments	✓		✓		
Related Parties			✓		
Appropriated Funds					
Provisions			✓		
Cash and Cash Equivalents	✓	✓	✓		
Reserves	✓		✓		
Financial Statements	✓		✓		✓
Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.					

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
<p><u>Risk assessment</u>: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.</p> <p><u>Control activities</u>: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.</p> <p><u>Information and communication</u>: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.</p> <p><u>Monitoring</u>: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.</p>					

## **Non-compliance with applicable legislation**

### **Municipal Finance Management Act**

36. Disclosure requirements in terms of section 123(1) of the MFMA regarding allocations received from government have not been complied with.
37. Disclosures in terms of section 125 have not been complied with respect to contributions to organized local government, pension, medical aid and taxes paid in respect of all staff of the municipality and whether any amounts were outstanding as at the end of the financial year, details of each bank account held including opening and year end balances and full disclosure of grants and subsidies.
38. Signed returns on conditional grant spending have not been submitted in terms of section 71 and section 31(2) of DoRA. Monthly financial reports are also not submitted and do not contain the prescribed information in terms of section 71.
39. The annual budget was not tabled at least 90 days before the start of the budget year in terms of section 16(2).
40. Funds collected on behalf of other organs of state are not being paid over weekly as required by section 64(4).
41. A fraud prevention plan and formal risk management policy or process has not been established and incorporated into the municipality's system to assess, manage and control risk on a continuous basis, contrary to section 62(1)(c).
42. The annual report for 2006/07 has not been tabled in Council and the reason for not submission has not been minuted in terms of section 127 and 130.
43. The website has not been updated to include the documentation required in terms of section 75(1).

### **Division of Revenue Act**

44. Evidence that quarterly and annual performance reports were submitted to National or Provincial Treasury could not be provided as in terms of section 11 and 12 .
45. The annual budget did not contain a three year capital budget for municipalities received the municipal infrastructure grant as required by section 15(4).

## Matters of governance

46. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
<b>Audit committee</b>		
• The municipality had an audit committee in operation throughout the financial year.		✓
• The audit committee operates in accordance with approved, written terms of reference.		✓
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		✓
<b>Internal audit</b>		
• The municipality had an internal audit function in operation throughout the financial year.		✓
• The internal audit function operates in terms of an approved internal audit plan.		✓
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		✓
<b>Other matters of governance</b>		
• The annual financial statements were submitted for audit as per the legislated deadlines (section 126 of the MFMA).		✓
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		✓
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		✓
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		✓
• The prior year's external audit recommendations have been substantially implemented.		✓
<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b>		
• The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.		✓
• The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.		✓
• The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.		✓



### **Unaudited supplementary schedules**

47. The supplementary information set out in page [xx] does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

### **OTHER REPORTING RESPONSIBILITIES**

#### **REPORT ON PERFORMANCE INFORMATION**

48. I was engaged to review the performance information.

#### **Responsibility of the accounting officer for the performance information**

49. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

#### **Responsibility of the Auditor-General**

50. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
51. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
52. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

#### **Audit findings (performance information)**

#### **Non-compliance with regulatory requirements**

#### **Performance information not received in time**

53. The financial statements submitted for auditing did not include a report on the performance information of the municipality, as required by *General Notice 616* as published in *Government Gazette No. 31057 dated 15 May 2008*; read with section 46 of the MSA and was still not received at the date of this report.

#### **Lack of systems generating performance information**

54. A formally documented framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and

managed, including determining the roles of the different role-players has not been adopted as required by chapter 6 of the MSA and regulation 7 of the Municipal Planning and Performance Management Regulations, 2001 (Regulation).

### **Content of integrated development plan**

55. Key performance indicators have not been updated or reviewed on an annual basis in terms of Regulation 11(1).

56. The service delivery and budget implementation plan (SDBIP) was not tabled in or approved by Council in terms of section 53(1)(c) of the MFMA. The SDBIP was not available for inspection.

### **No quarterly reporting on performance information**

57. Quarterly reports and half yearly reports assessing the performance of the municipality were not prepared as required by section 41 of the MSA and section 72(1) of the MFMA respectively.

### **APPRECIATION**

58. The assistance rendered by the staff of the Dannhauser Municipality during the audit is sincerely appreciated.

Pietermaritzburg

28 November 2008



A U D I T O R - G E N E R A L